

**Dear CAF 7 Students,**

**These notes are a summarized version of questions prepared from INCOME TAX ORDINANCE 2001. These notes are mainly for revision purposes.**

**Do not wholly and solely depend on them.**

**It has a coverage of tax year 2015 - 2016.**

**Good luck for your exams.**

**Regards,**

**Sanam Alam**

## SALARIED TAX PAYERS

|    | From      | To        | Rate of Tax        |                                       |
|----|-----------|-----------|--------------------|---------------------------------------|
| 1  | 0         | 400,000   | 0%                 |                                       |
| 2  | 400,001   | 500,000   | 2%                 | of the amount exceeding Rs 400,000    |
| 3  | 500,001   | 750,000   | Rs. 2,000 + 5%     | of the amount exceeding Rs 500,000.   |
| 4  | 750,001   | 1,400,000 | Rs 14,500 + 10%    | of the amount exceeding Rs 750,000.   |
| 5  | 1,400,001 | 1,500,000 | Rs 79,500 + 12.5%  | of the amount exceeding Rs 1,400,000. |
| 6  | 1,500,001 | 1,800,000 | Rs 92,000 + 15%    | of the amount exceeding Rs 1,500,000. |
| 7  | 1,800,001 | 2,500,000 | Rs 137,000 + 17.5% | of the amount exceeding Rs 1,800,000. |
| 8  | 2,500,001 | 3,000,000 | Rs 259,500 + 20%   | of the amount exceeding Rs 2,500,000. |
| 9  | 3,000,001 | 3,500,000 | Rs 359,500 + 22.5% | of the amount exceeding Rs 3,000,000. |
| 10 | 3,500,001 | 4,000,000 | Rs 472,000 + 25%   | of the amount exceeding Rs 3,500,000. |
| 11 | 4,000,001 | 7,000,000 | Rs 597,000 + 27.5% | of the amount exceeding Rs 4,000,000. |
| 12 | 7,000,000 | ~         | Rs 1,422,000 + 30% | of the amount exceeding Rs 7,000,000. |

## NON-SALARIED TAX PAYERS

|   | From      | To        | Rate of Tax        |                                       |
|---|-----------|-----------|--------------------|---------------------------------------|
| 1 | 0         | 400,000   | 0%                 |                                       |
| 2 | 400,001   | 500,000   | 7%                 | of the amount exceeding Rs 400,000    |
| 3 | 500,001   | 750,000   | Rs. 7,000 + 10%    | of the amount exceeding Rs 500,000.   |
| 4 | 750,001   | 1,500,000 | Rs 32,000 + 15%    | of the amount exceeding Rs 750,000.   |
| 5 | 1,500,001 | 2,500,000 | Rs 144,500 + 20%   | of the amount exceeding Rs 1,500,000. |
| 6 | 2,500,001 | 4,000,000 | Rs 344,500 + 25%   | of the amount exceeding Rs 2,500,000. |
| 7 | 4,000,001 | 6,000,000 | Rs 719,500 + 30%   | of the amount exceeding Rs 4,000,000. |
| 8 | 6,000,000 | ~         | Rs 1,319,500 + 35% | of the amount exceeding Rs 6,000,000. |

# INCOME FROM SALARY

## (Receipt basis)

### 1. Interest free or reduced rate loans

- Bench mark rate is 10%
- Applied only on loans above Rs. 500,000

### 2. Rent free Accommodation

- HIGHER of:
  - ◆ Fair market value
  - ◆ 45% of MTS or Basic salary

### 3. Salaried individuals are those whose source of income is 50% from salary

### 4. Shares

- **Unrestricted shares**
  - ◆ FMV on date of issuance – Cost
- **Restricted shares**
  - ◆ FMV on the date EARLIER of
    - Date of free right
    - Date disposed

### 5. Gratuity

- **Approved by:**
  - ◆ Commission: fully exempt
  - ◆ Board: exempt up to 200,000
- **Unapproved:**
  - ◆ Exempt up to LOWER of:
    - 75000
    - 50% of amount receivable

### 6. Pension

|                            |                      |
|----------------------------|----------------------|
| • 1 pension:               | Exempt               |
| • 1+ Pensions:             | HIGHER one is exempt |
| • 1+ pensions and 60+ age: | All exempt           |

## **7. Provident fund**

- **Unrecognized**

- ◆ Timings:

Upon Receipt

- **Recognized**

|                         |   |
|-------------------------|---|
| Timings                 | Annually  |
| Interest                | Exempt up to HIGHER of: <ul style="list-style-type: none"><li>• 16% of interest on accumulated balance</li><li>• 1/3 of (Basic Salary + Dearness Allowance)</li></ul> |
| Employer's contribution | Exempt up to LOWER of: <ul style="list-style-type: none"><li>• 100,000</li><li>• 10% of (Basic Salary + Dearness Allowance)</li></ul>                                 |

## **8. Golden handshake**

- Separate block of income
- Taxed with a special rate

- **Formula of the rate:**

- ◆ Tax liability of last 3 years / tax income of last 3 years

## **9. Tax Credits & Tax Rebates**

- **Format:**

|   |       |
|---|-------|
| ◆ Tax liability of a person             | xxx   |
| Less: Senior citizen allowance          | (xxx) |
| Full time teacher/researcher allowance  | (xxx) |
| Foreign tax credits                     | (xxx) |
|   | xxx   |
| Less: Tax credits under section 61 – 65 | (xxx) |
| Net Tax liability                       | xxx   |

- **Senior citizen allowance**

- ◆ Eligibility: Individual over 60 years on the first day of tax year
  - ◆ Allowance: tax liability is reduced by 50%
  - ◆ Only available if taxable income is less than 1 million rupees

- **Full time teacher/researcher allowance**

- ◆ Allowance: tax liability is reduced by 40%
  - ◆ Only available if the person works for an approved institution

- If a person is eligible for both SCA and FTTA, tax liability will be first reduced by SCA and the remaining will be reduced by 40%

- Ensure you calculate the FTTA separately if income is from 2 different sources
- Foreign tax credits **(IF PAID WITHIN 2 YEARS)**:
  - ♦ the taxpayer shall be allowed a tax credit of an amount equal to the lesser of:
    1. the foreign income tax paid; or
    2. the Pakistan tax payable

Formula:

**Average rate of tax x FSI**

Where, average rate of tax is: tax liability/taxable income

- **Section 61 – 65**

♦ **Charitable donations (61)**

**1. Normally approved**

- Examples: Sadqa, Khairat
- Allowance: it reduces tax liability
- Needs to be done by banking channel
- **Formula:**  
Tax credit = Average rate of tax x Eligible Amount

Where:

Average rate of tax = tax liability / taxable income

Eligible Amount = LOWER of:

- Actual donation
- 30% of taxable income (individual & AOP)
- 20% of taxable income (company)

**2. Mentioned in 2<sup>nd</sup> schedule**

- Eligible for direct deduction
- \*no condition of banking channel applicable
- \*If donations are in form of kind, their FMV on the day it was transferred will be its amount.
- \* shall not exceed 30% of the taxable income in the case of individual and AOP and 20% in the case of company

♦ **Investment in shares + contribution to life insurance (62)**

1. Only applicable for individuals and AOP
2. You can only get reduction in tax liability over one of them

**3. Shares:**

- a. new shares of listed public or private company
- b. mutual fund units
- c. shares offered by privatization commission

**4. Formula:**

Tax credit = Average rate of tax x Eligible Amount

Where:

Average rate of tax = tax liability / taxable income

Eligible Amount = LOWER of:

- Actual donation
- 20% of taxable income
- 1.5 million rupees

**♦ Contribution to approved pension funds (63)**

**1. Formula:**

Tax credit = Average rate of tax x Eligible Amount

Where:

Average rate of tax = tax liability / taxable income

Eligible Amount = LOWER of:

- Actual donation
  - 20% of taxable income
- OR
- If above age of 40, every year more than 40 you will get 2% (Maximum up to 50%)

**♦ Profit on debt (64)**

**1. Formula:**

Tax credit = Average rate of tax x Eligible Amount

Where:

Average rate of tax = tax liability / taxable income

Eligible Amount = LOWER of:

- Actual donation
- 50% of taxable income
- 1,000,000 rupees

2. If loan is taken to build a house In order to rent it out, it will be deducted from INCOME FROM PROPERTY

**10. Medical facility & allowance**

|                   | In Accordance    | Not In Accordance | No NTN        |
|-------------------|------------------|-------------------|---------------|
| Medical Facility  | Fully Exempt     | Fully Taxable     | Fully Taxable |
| Medical Allowance | Exempt Up To 10% | Exempt Up To 10%  | Not Required  |
| <u>MF + MA</u>    |                  |                   |               |
| Medical Facility  | Fully Exempt     | Fully Taxable     | Fully Taxable |
| Medical Allowance | Fully Taxable    | Exempt Up To 10%  | Fully Taxable |

## 12. Car

|                 |     |
|-----------------|-----|
| Personal        | 10% |
| Personal + work | 5%  |
| Work            | 0%  |

13. The tax treatment of any contribution to and from the approved superannuation fund or a Benevolent Fund is as under:

- Employer's contribution is exempt from tax.
- Interest on accumulated balance is exempt from tax.

## INCOME FROM PROPERTY

1. Rental income works on accrual basis
2. FMV is considered as income even if you receive less
3. Value of property = rental / 0.5%
4. **Cancellation of a deal**
  - a. Buyer: he loses token money
  - b. Seller: he loses token money x 2
5. **Exemptions:** Rental received from agricultural land
6. If a property is rented out along with machinery, it will be included in INCOME FROM OTHER SOURCES
7. Money received from tenants for maintenance, utilities etc. is INCOME FROM OTHER SOURCES
8. **Format:**

|                          |       |
|--------------------------|-------|
| Rent Received/Receivable | xxx   |
| Forfeited deposit        | xxx   |
| Non-adjustable rent      | xxx   |
| Less: deductions         | (xxx) |

### 9. Non-adjustable rent (deposit)

Include it at the rate of 1/10 every year

**If there is an old and new tenant:**

|  |            |
|--|------------|
| New deposit                            | xxx        |
| Less: deposit already taxed            | <u>xxx</u> |
| Amount to be added in subsequent years | <u>xxx</u> |

Now divide it by 10

### 10. Deductions

- a. Repair and maintenance: 1/5 of rent chargeable to tax
- b. Collection charges: LOWER of
  - i. 6% of rent chargeable
  - ii. Actual
- c. Insurance premium
- d. Taxes (other than levied under income tax ordinance)
- e. Ground rent
- f. Legal charges for defending a legal suit
- g. Profit on debt: if loan is taken to build a property to put up on rent (lower of actual, 50% of taxable inc or 1 m rupees)
- h. **Unrecoverable rent:** it can be claimed if the following conditions are fulfilled
  - i. Rent is already claimed as income
  - ii. Action taken to vacate property & legal proceedings to recover the amount
  - iii. Tenant doesn't have possession of another property

### 11. Amounts to add:

- a. Unrecoverable rent subsequently recovered
- b. Expenses you claimed but didn't settle till 3 years



# INCOME FROM BUSINESS

## 1. Format

|                              |              |
|------------------------------|--------------|
| Accounting profit before tax | xxx          |
| Add: Expenses not allowed    | xxx          |
| Income not recognized        | xxx          |
| Less: Admissible Expenses    | (xxx)        |
| Recorded income              | <u>(xxx)</u> |
| Taxable income               | <u>xxx</u>   |

2. **Individual & AOP:** cash basis or accrual basis  
**Company** : accrual basis

## 3. To be included:

- Profits & gains
- Sales of goods/ services rendered
- Leasing rentals
  - Moveable property: INCOME FROM BUSINESS
  - Immoveable property: INCOME FROM PROPERTY
- Incentives received from achieving goals
- Modarabas management fee

4. Interest received is INCOME FROM OTHER SOURCES unless it's a financial institution

## 5. Deductions not allowed:

- Income tax paid/payable
- As an employer you didn't deduct tax from employee's salary, that whole salary will not be allowed as deduction
- Entertainment expense (if it exceeds limits)
- Fine & penalty
- Contribution to unrecognized funds
- If the recognized fund doesn't withhold tax from payments, those payments on behalf of employer will also be disallowed
- Personal expenditures
- Capital expenditure fund
- Interest & salary to a partner
- Salary exceeding 15000 not done through banking channels
- Capital nature expense giving benefit for +1 years
- Payments done more than Rs.50000 not done through banking channels
 

**Exceptions:** (if all payments are less than 10k each transaction)

  - Utility expense
  - Freight
  - Travel
  - Post
  - Taxes
  - Fines

## 6. Third Schedule

- a. **Depreciation** (charged full in the year of purchase and none in the year of disposal)
  - i. Buildings: 10%
  - ii. Plant & Machinery: 15%

- b. **Initial allowance:**

- i. Buildings: 15%
  - ii. Plant & Machinery: 25%

- c. **First year allowance:** 90%

- d. **Amortisation of pre-commencement expenditure:** 20% straight line method

|  |                 |
|--|-----------------|
| e. Computer hardware including printer, monitor and allied items, Machinery & Equipment used in manufacture of IT Products, aircrafts and aero engines.  | 30%             |
| f. In case of mineral oil concerns the income of which is liable to be computed in accordance with the rules in Part-I of the Fifth Schedule.<br>(a) Below ground installations<br>(b) Offshore platform and production Installations. | 100%<br><br>20% |
| g. A ramp built to provide access to persons with disabilities not exceeding Rs. 250,000 each.   | 100%            |

## 7. Intangibles:

- a. **Amortization**

- i. Less than 10 years (amortized on actual life)
  - ii. More than 10 years or definite (amortized on 10 years)

## 8. Calculation of loss/gain

|  |            |
|--|------------|
| Disposal proceeds                              | xxx        |
| Less: WDV of asset                             | (xxx)      |
| Depreciation not claimed due to personal usage | (xxx)      |
| Loss/gain                                      | <u>xxx</u> |

## 9. Employee training & facilities

Operational expenditures will be allowed as deduction if:

- i. Expenditure is to run the place (not build)
  - ii. It's a school or hospital
  - iii. Training (scheme approved by government)

## 10. Deductions

- i. Bad debts
- ii. Profit on debt
- iii. Lease payments
- iv. Depreciation expense
- v. All expenses part of the business

## CAPITAL GAINS

### 1. All assets except:

- a. Business inventory
- b. Depreciable assets and intangibles (their gain/loss is included in INCOME FROM BUSINESS)
- c. Moveable property held for personal use

### 2. What is included?

- a. Immoveable personal property
- b. Investment in shares, modarabas etc.
- c. Assets in section 38(5)
  - i. Painting
  - ii. Jewellery
  - iii. Folio
  - iv. Postage stamp
  - v. Coins
  - vi. Antique pieces

### 3. All assets except securities of listed companies (sec 37)

#### a. Tax rate to be paid

- i. Holding period <1 year: 10%
- ii. Holding period >1 but <2 years: 5%
- iii. Holding period >2 years: 0%

- b. Gain on assets held for more than 1 year is exempted by 25%

### 4. Securities of listed public or listed private companies (37A)

| S.No. | Period  | Tax Year<br>2015 | Tax Year<br>2016 |
|-------|---|------------------|------------------|
| (1)   | (2)   | (3)              | (4)              |
| 1.    | Where holding period of a security is less than twelve months.                                | 12.5%            | 15%              |
| 2.    | Where holding period of a security is twelve months or more but less than twenty four months. | 10%              | 12.5%            |
| 3.    | Where holding period of a security is twenty four months or more but less than four years.    | 0%               | 7.5%             |
| 4.    | Where holding period of a security is more than four years                                    | 0%               | 0%               |

5. The cost of a gift, something received from inheritance or distribution of AOP or company will be its FMV

6. Losses to be allowed are whose gain would've been taxed

**7. No losses shall be allowed on disposal of:**

- i.** Painting
- ii.** Jewellery
- iii.** Folio
- iv.** Postage stamp
- v.** Coins
- vi.** Antique pieces

## **INCOME FROM OTHER SOURCES (receipt basis)**

### **1. To be included**

- a. Dividend
- b. Royalty
- c. Profit on debt
- d. Additional payment on delayed refund by tax authorities (6 months delay)
- e. Ground rent
- f. Rent on Sub lease
- g. Lease of building + plant installed in it
- h. Amenities, utilities & services connected with rented buildings
- i. Voluntary Annuity or pension
- j. Prize bond, raffle, lottery etc.
- k. Grant
- l. FMV of benefit in relation to use or exploitation of property
- m. Consideration received to vacate property (less cost paid) (divide it in 10 years)
- n. Shareholders receiving income from bonus shares
- o. Loan taken in cash (not through banking channels)

### **2. Deductions**

- a. All expenses incurred to derive such income
- b. Paid zakat on the interest earned which falls in INCOME FROM OTHER SOURCES
- c. Depreciation & initial allowance on plant, machinery or building used to derive INCOME FROM OTHER SOURCES
- d. Expenditure of capital nature

3. Any amount received by a person as consideration for vacating the possession of a building or part thereof, reduced by any amount paid by the person to acquire possession of such building or part thereof. This income shall be taxable in 10 years from the year of receipt in equal proportion.

## OTHER DETAILS

1. Rates of tax for companies: 33%.
2. Rate of tax for small company: 25%
3. Tax rates on gross amount of dividend
  - General tax rate – 10%
  - Dividend by purchaser of power project – 7.5%
  - Dividend from a power generation company – 7.5%
  - Dividend from a stock fund – 12.5%
  - Dividend received by a co. from collective investment / mutual fund etc. – 25%
4. Pakistan source royalty or fee for technical services received by a non-resident person is subject to final tax @ 15% of the gross receipts.

The above provision shall not apply to

  - (i) Any royalty & fee for technical services which is connected with a permanent establishment in Pakistan of the non-resident person.
  - (ii) exempt from tax
5. minimum tax regime: Tax deduction at source @ 10% from gross amount of service rendered for all persons other than a company
6. Any common expenditure (including financial expenses) shall be apportioned amongst each class of income according to the following formula:
$$\text{Amount of expense} \times \frac{\text{Gross receipts for the class of income}}{\text{Gross receipts for all class of income}}$$
- 7.